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SUBJECT: Bolivia: No major changes predicted in gas industry

REF: 09 LA PAZ 267

¶1. (U) Summary: Bolivia's natural gas production fell in 2009 due to reduced regional demand, dropping from 40-42 million cubic meters a day (Mm3/d) in 2008 to the current 33 Mm3/d. Natural gas exports also fell as a percentage of the value of total exports, from 45 percent in 2008 to 37 percent in 2009. Current gas production is divided among domestic consumption (7 Mm3/d), exports to Brazil (21 Mm3/d), and exports to Argentina (5 Mm3/d). Brazilian demand is falling, and plans for increased exports to Argentina remain held up because of pipeline capacity and supply concerns. Bolivian reserves remain estimated to be the second largest in South America, at around 1.36 trillion cubic meters (48 trillion cubic feet). End Summary.

¶2. (SBU) Bolivia's gas supply agreement with Brazil requires Brazil to take 24 Mm3/d or at least pay for that amount (it may take up to 31Mm3/d). In 2009 Brazil averaged closer to 21 Mm3/d and will pay for the difference (creating a credit it can use in the future). Brazil also pays extra for the liquids (petroleum) that come with the gas, just concluding an agreement with the GOB as to the cost -- approximately \$100 million for 2007 and expected to be \$300 million for 2008-2009. Payment for 2007 has occurred, but payment for 2008-2009 will not happen until a separate agreement identifying the level of domestic demand is sorted out.

¶3. (SBU) The current contract with Brazil is valid until 2019, and Brazilian Embassy representatives told us the contract will likely be renewed after that date. Brazil believes Bolivian gas is convenient and remains a relatively cheap energy option. There is also a political component that will ensure a continued relationship. On February 3, President Lula of Brazil caused controversy by saying, "we will continue to buy Bolivian gas because we need to help our poor neighbors, because this is the role of a country the size of Brazil." Bolivian Vice-President Garcia Linera responded by saying, "The contract requires obligatory compliance, independent of the ruler's goodwill, which

we appreciate. The contract will be fulfilled." Still, the level of gas Brazil buys will depend greatly on other resources, including development of a recently-discovered Brazilian off-shore oil field.

¶4. (U) During a visit to Bolivia in November 2009, Spanish Repsol CEO Brufau committed \$1.5 billion in investments over the next 5 years to increase production at the Tarija region's Margarita field to 14 Mm3/d by 2013 (it currently produces 2 Mm3/d). As of February 2010, however, no new investment has been made and it is uncertain if other investors in Margarita will also increase investments. The pace of any increased production will likely continue to depend on how quickly the pipeline to Argentina increases transportation capacity. The Spanish believe that only 30% of the financing for the pipeline expansion has been obtained.

¶5. (U) In January the Bolivian state hydrocarbons company, YPFB, announced a five-year investment plan worth \$11 billion. While unveiling the program, President Morales said, "I dream of having our state company become as important as Brazil's Petrobras or Venezuela's PDVSA." French company Total also recently announced new investment plans, beginning with exploratory drilling (in conjunction with Tecpetrol of Argentina) at the Incahuasi field in the Caraparicito zone of Santa Cruz. The initial investment of \$70

million could expand to \$500 million over five years if the drilling is successful, potentially adding 5 Mm3/d to Bolivian production by 2013.

¶6. (SBU) A contract signed by Argentina and Bolivia in 2006 committed Bolivia to steadily raise supply to Argentina, supposedly already reaching 27 Mm3/d. Both Argentina and Bolivia recognize that this is not possible with neither paying penalties for not meeting the take-or-pay or deliver-or-pay clauses. The pipeline to Argentina currently only has the capacity for 7 Mm3/d, and actual delivery is closer to 4-5 Mm3/d. The Argentines tell us they are willing to take more gas, but understand that expansion of the pipeline needs to come first. Bolivia must build 20 km of pipeline to connect the Margarita field to the main pipeline and Argentina must build 40km on its side to make connections to the larger pipelines there. Construction has not begun on either side, awaiting increased certainty of supply.

¶7. (SBU) In general, most investors are waiting for the new hydrocarbons law to provide more certainty for the sector. Still, it appears the GOB is not seeking broad consultations with investors but is getting advice from the IDB on this and other new laws. The laws are expected to lay out new investment rules for the sector, likely increasing the percentage of state involvement in any new investments. The law will also likely raise taxes and/or royalties hydrocarbons companies pay. Other than increased production out of Margarita by Repsol, there are no other large increases predicted for the near future. Based on likely demand, Bolivian production is likely to stay close to 30-35 Mm3/d for the next 4-5 years. The potential production capacity should remain at around 40-45 Mm3/d.

¶8. (SBU) The Bolivian state oil company, YPFB, has approached various donors for assistance. The World Bank, Inter-American Development Bank (IDB), Canada, Norway, and the Netherlands have formed a group to provide technical assistance to YPFB on restructuring. The assistance will focus on management restructuring and procurement and will entail the secondment of a Dutch consultant (likely a retired Shell professional) to YPFB to assist. This could be a good sign, signaling that YPFB recognizes that it does not have sufficient technical capacity and is open to assistance.

¶9. (SBU) The GOB has also requested international assistance on the construction of a petrochemical facility. The Dutch are providing technical assistance and the Brazilian company Braskem (40% owned by Odebrecht, with PetroBras holding a significant minority stake) is reportedly very interested in the project. If the project were to occur, it would be a joint venture with a Bolivian state company. The idea for this facility has been in discussion for 10 years, however, and it would need at least 5 years to come to fruition. Upon completion, this facility could drastically increase demand for natural gas, possible using up to 15 Mm3/d.

¶10. (SBU) The new Bolivian Hydrocarbons Minister, Fernando Vargas, has served on the board of YPFB for four years and is a civil engineer from Santa Cruz. Vargas is not believed to have broad sectoral knowledge. He is, however, very close to Vice President

Garcia Linera, leading to speculation that the vice president will have ultimate control over this critical sector. Vargas seems to also have a good relationship with Villegas, the President of YPFB.

¶11. (SBU) Comment: Gas remains critical to Bolivia's fiscal and economic future. Without gas revenue, Bolivia's fiscal deficit in 2008 would have exceeded 8% of GDP. With Brazilian demand now at around 21 Mm3/d and with domestic supply unlikely to rise dramatically, the future of the Bolivian gas market faces a "chicken and egg" scenario - will new production from the Margarita field start without the increased availability in the pipeline to export it to Argentina? Many hope the new hydrocarbons law will reduce uncertainty and spur investment in the sector (although the law does not seem to be a high priority for the GOB), but significant increases in Bolivian production and exports are not likely for several years at least.
Creamer